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Enforcement Directorate Investigates Cryptocurrency OTC Scam, Renewing Focus on Money Laundering Risks and India’s Anti-Money Laundering Framework

Published On: 24-07-2026

Recent Developments:

- The **Directorate of Enforcement (ED)** has initiated an investigation under the **Prevention of Money Laundering Act (PMLA), 2002** into an alleged **US$35 million Cryptocurrency Over-the-Counter (OTC) Trading Scam** involving suspected laundering of proceeds generated through illegal cryptocurrency transactions.
- The investigation highlights the growing use of **Virtual Digital Assets (VDAs)**, **OTC crypto trading**, and cross-border digital payment channels for concealing the origin of illicit funds.
- The case has once again drawn attention to India's **Anti-Money Laundering (AML)** architecture, regulatory oversight of digital assets, and the need for stronger international cooperation against financial crimes.

Money Laundering:

Meaning, Definition:

- **Money Laundering** is the process of concealing the illegal origin of proceeds generated from criminal activities and presenting them as legitimately earned assets.
- It enables criminals to integrate illicit wealth into the formal financial system while disguising its criminal source.
- The offence generally originates from **predicate offences** such as **drug trafficking**, **terrorism financing**, **corruption**, **fraud**, **human trafficking**, **tax evasion**, **cybercrime**, **organized crime**, and **illegal wildlife trade**.
- The **Financial Action Task Force (FATF)** defines money laundering as the processing of criminal proceeds to disguise their illegal origin and facilitate their integration into the legitimate economy.

Three Stages of Money Laundering:

Placement, Layering, Integration:

- **Placement** involves introducing illegally obtained cash or assets into the formal financial system through bank deposits, shell companies, casinos, cryptocurrencies, or high-value purchases.
- **Layering** involves carrying out multiple complex financial transactions, transfers across jurisdictions, conversion into digital assets, and movement through shell entities to obscure the audit trail.
- **Integration** represents the final stage where laundered money re-enters the economy as apparently legitimate income through investments, businesses, luxury assets, securities, or real estate.

Major Sources of Money Laundering:

Predicate Offences:

- Major sources include:
- **Drug trafficking**, **terrorism financing**, **corruption**, **financial fraud**.
- **Cybercrime**, **bank fraud**, **Ponzi schemes**, **hawala transactions**.
- **Tax evasion**, **illegal mining**, **wildlife trafficking**, **human trafficking**.
- **Cryptocurrency-enabled financial crimes** and **cross-border organised crime**.

How Money Laundering Operates Through Cryptocurrencies:

Role of Virtual Digital Assets:

- Cryptocurrencies facilitate rapid cross-border transfers with comparatively greater transactional privacy.
- Criminals often exploit:
- **OTC crypto markets**, **privacy coins**, **crypto mixers**, **decentralised exchanges**, **multiple wallets**, and **cross-chain bridges**.
- Although blockchain transactions remain traceable, identifying the beneficial owner often requires sophisticated forensic investigation.
- The increasing adoption of **Virtual Digital Assets** has expanded both legitimate financial innovation and opportunities for illicit financial flows.

Impact of Money Laundering:

Economic Impact:

- Money laundering weakens the integrity, transparency, and credibility of the financial system.
- Large volumes of illicit capital distort:
- **Interest rates**, **exchange rates**, **capital markets**, and **resource allocation**.
- Artificial capital flows reduce market efficiency and create macroeconomic instability.
- Weak financial governance discourages **Foreign Direct Investment (FDI)** by increasing regulatory and reputational risks.

Fiscal Impact, Public Welfare:

- Laundered income escapes taxation, reducing government revenue.
- Reduced fiscal resources constrain expenditure on:
- **Health**, **education**, **infrastructure**, **social protection**, and **poverty alleviation**.
- Corruption financed through illicit wealth undermines democratic governance and public confidence in institutions.

Impact on Asset Markets:

- Illicit funds frequently enter:
- **Real estate**, **luxury goods**, **gold**, **art markets**, and **high-value assets**.
- Artificial demand inflates property prices, reducing housing affordability for genuine buyers.
- Asset price bubbles may emerge without corresponding economic productivity.

Impact on National Security:

- Money laundering finances:
- **Organised crime**, **terrorism**, **extremism**, **drug cartels**, and **transnational criminal networks**.
- Criminal organisations strengthen operational capacity through access to concealed financial resources.
- Illicit financial flows threaten internal security and economic sovereignty.

Emerging Challenges in Combating Money Laundering:

Digital Banking, FinTech:

- Digital banking enables instantaneous domestic and international financial transfers.
- Large transaction volumes require **Artificial Intelligence**, **Machine Learning**, and **risk-based transaction monitoring** instead of manual scrutiny.
- Fraud detection increasingly depends upon behavioural analytics rather than isolated transactions.

Cryptocurrencies, Decentralised Finance:

- **Virtual Digital Assets**, **Decentralised Finance (DeFi)** platforms, and **peer-to-peer trading** reduce reliance on traditional financial intermediaries.
- Anonymous wallet creation, cross-border transactions, and decentralised exchanges complicate regulatory supervision.
- Regulators increasingly mandate **Know Your Customer (KYC)** and **Anti-Money Laundering (AML)** compliance for **Virtual Asset Service Providers (VASPs)** in line with FATF standards.

Cross-Border Transactions:

- Criminal proceeds frequently move across multiple jurisdictions before reaching their final destination.
- Differences in legal frameworks, banking secrecy laws, and mutual legal assistance procedures delay investigation and prosecution.

India's Legal Framework Against Money Laundering:

Prevention of Money Laundering Act (PMLA), 2002:

- The **Prevention of Money Laundering Act, 2002** was enacted under **Article 253** of the Constitution to implement India's international obligations against money laundering.
- The Act came into force on **1 July 2005** and has subsequently been amended in **2009**, **2012**, **2019**, and **2023** to strengthen enforcement and align with evolving international standards.
- The Act provides for:
- **Prevention of money laundering**.
- **Attachment**, **seizure**, and **confiscation** of proceeds of crime.
- **Investigation**, **prosecution**, and **adjudication** of offences.
- Obligations upon **banking companies**, **financial institutions**, and **reporting entities** regarding customer due diligence and transaction reporting.

Proceeds of Crime:

- **Section 2(1)(u)** defines **Proceeds of Crime** as any property derived or obtained, directly or indirectly, from criminal activity relating to a scheduled offence.

Offence of Money Laundering:

- **Section 3** criminalises any person who directly or indirectly attempts to indulge, knowingly assists, knowingly becomes a party, or is actually involved in activities connected with proceeds of crime, including concealment, possession, acquisition, use, or projection as untainted property.

Scheduled Offences:

- The Schedule includes offences under numerous laws, including:
- **Indian Penal Code, 1860** (replaced prospectively by the **Bharatiya Nyaya Sanhita, 2023** where applicable).

- **Narcotic Drugs and Psychotropic Substances Act, 1985**.
- **Prevention of Corruption Act, 1988**.
- **Wild Life (Protection) Act, 1972**.
- **Information Technology Act, 2000**.
- Several other economic and special criminal statutes.

Directorate of Enforcement (ED):

Evolution, Organisation:

- The **Enforcement Directorate** originated in **1956** as the **Enforcement Unit** under the **Department of Economic Affairs**.
- It was subsequently renamed the **Enforcement Directorate**.
- The organisation presently functions under the **Department of Revenue**, **Ministry of Finance**.
- It is a specialised multidisciplinary investigation agency responsible for combating economic crimes.

Major Functions:

- Investigation and prosecution under the:
- **Prevention of Money Laundering Act, 2002**.
- **Foreign Exchange Management Act, 1999 (FEMA)**.
- **Fugitive Economic Offenders Act, 2018**.
- Identification, attachment, seizure, and confiscation of proceeds of crime.
- Coordination with domestic agencies and foreign jurisdictions in financial investigations.

Institutional Framework Against Money Laundering:

Key Institutions:

- **Financial Intelligence Unit – India (FIU-IND)** receives and analyses suspicious transaction reports from reporting entities.
- **Reserve Bank of India (RBI)** prescribes AML and KYC norms for regulated financial institutions.
- **Securities and Exchange Board of India (SEBI)** supervises AML compliance in securities markets.
- **Insurance Regulatory and Development Authority of India (IRDAI)** monitors AML compliance within the insurance sector.
- **Central Board of Direct Taxes (CBDT)** and **Central Board of Indirect Taxes and Customs (CBIC)** support financial intelligence and tax investigations.

International Framework:

Financial Action Task Force (FATF):

- **FATF** was established in **1989** by the **G7** countries.
- It is the global standard-setting body for combating:
- **Money Laundering**, **Terrorist Financing**, and **Proliferation Financing**.
- FATF issues the internationally accepted **40 Recommendations**, conducts **Mutual Evaluations**, and identifies jurisdictions with strategic AML deficiencies.
- India became a **FATF Member** in **2010**.

United Nations Convention Against Transnational Organized Crime (UNTOC):

- The Convention promotes international cooperation against organised crime, money laundering, corruption, and illicit trafficking.

- It encourages mutual legal assistance, extradition, and asset recovery.

United Nations Convention Against Corruption (UNCAC):

- UNCAC contains provisions on:
- **Asset recovery**, **international cooperation**, **anti-corruption measures**, and **prevention of illicit financial flows**.

Recent Reforms Related to Virtual Digital Assets:

Regulatory Developments:

- India has brought **Virtual Digital Asset Service Providers** within the ambit of the **Prevention of Money Laundering Act** by notifying them as **Reporting Entities**.
- Crypto exchanges are required to:
- Conduct **KYC**.
- Maintain transaction records.
- Report suspicious transactions.
- Comply with customer due diligence obligations.
- These reforms seek to balance technological innovation with financial integrity.

Challenges in India's Anti-Money Laundering Framework:

Operational Challenges:

- Increasing sophistication of financial crimes involving cryptocurrencies and digital assets.
- Complex cross-border financial structures and beneficial ownership concealment.
- Delays in investigation, prosecution, and judicial disposal.
- Limited international cooperation in certain jurisdictions.
- Low conviction rates despite increasing investigations.
- Capacity constraints in financial forensic investigation.

Way Forward:

Policy Measures:

- Strengthen financial intelligence using **Artificial Intelligence**, **Machine Learning**, and advanced blockchain analytics.
- Improve coordination among **ED**, **FIU-IND**, **RBI**, **SEBI**, tax authorities, and international enforcement agencies.
- Enhance judicial capacity for expeditious disposal of economic offences.
- Expand beneficial ownership transparency across corporate structures.
- Strengthen regulation of **Virtual Digital Assets**, while encouraging responsible technological innovation.
- Increase public awareness regarding digital financial fraud and cryptocurrency-related scams.

UPSC Value Addition:

Important Constitutional Provision:

- **Article 253 —** Parliament's power to legislate for implementing international treaties and obligations.

Important Acts:

- **Prevention of Money Laundering Act, 2002**.

Kamaraj IAS Academy
Plot A P.127, AF block, 6 th street, 11th Main Rd, Shanthi Colony, Anna Nagar, Chennai, Tamil Nadu 600040
Phone: **044 4353 9988 / 98403 94477** / Whatsapp : **09710729833**

- **Foreign Exchange Management Act, 1999**.
- **Fugitive Economic Offenders Act, 2018**.
- **Benami Transactions (Prohibition) Amendment Act, 2016**.

Important Institutions:

- **Directorate of Enforcement (ED)**.
- **Financial Intelligence Unit – India (FIU-IND)**.
- **Financial Action Task Force (FATF)**.
- **Reserve Bank of India (RBI)**.
- **Securities and Exchange Board of India (SEBI)**.

Important Terms:

- **Money Laundering**.
- **Proceeds of Crime**.
- **Predicate Offence**.
- **Know Your Customer (KYC)**.
- **Anti-Money Laundering (AML)**.
- **Virtual Digital Assets (VDAs)**.
- **Virtual Asset Service Providers (VASPs)**.
- **Over-the-Counter (OTC) Trading**